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Kaifu Dissolves Lower House For February 18 Elections

Prime Minister Toshiki Kaifu dissolved the House of Representatives January 24 and formally set February 18 as the day Japanese voters will go to the polls to select their lower house representatives. In a special cabinet meeting the government also set February 3 for candidate registration and the official start of the election season. The ruling Liberal Democratic Party's 34-year leadership of the Japanese government will be at stake in these elections due to its unprecedented losses to the noncommunist parties in the July House of Councillors elections. The LDP's failure to win at least a simple majority of 257 seats in the lower house contests would precipitate important changes in Japan's postwar political structure -- changes that probably would include formation of a LDP/opposition party coalition government as well as Mr. Kaifu's resignation.

In the traditional preelection "pep talk" following dissolution of the lower house, Mr. Kaifu called on his LDP colleagues to do their utmost to secure at least 257 seats. The ruling party currently holds 294 seats in the lower chamber, which means that the LDP controls all of the lower house committees

important political decisions. It remains to be seen how this ostensible "back-room wheeling and dealing" -- precisely the style of politics to which voters reacted in the upper house elections -- plays back in the home districts.

Barbara Wanner

Japan's Trade Surplus Falls For Third Year

A year ago Japan's trade surplus looked intractable. The effect of the near doubling in the yen's value between 1985 and 1988 appeared to have run its course, with the imbalance stuck at a high, politically unsustainable level. Between July 1988 and March 1989 the dollar-denominated quarterly surplus actually increased in a year-to-year comparison. Japan's surplus with the United States also widened during 1988's last quarter and the first three months of 1989. The handwringers paid little attention to other, broader measures, such as the current account, that suggested the situation was a good deal murkier -- and more favorable to those hoping for a smaller imbalance -- than the trade figures suggested. During this period the so-called revisionist school gained influence with many U.S. opinion leaders, who argued that the then current trade figures indicated that Japan's economy did not respond to market signals the way American economists and political leaders had assumed it would.

A year later Japan's overall trade surplus is still large. However, most analysts admit that events in the last half of 1989 suggested at least some movement. For the year exports were up a scant 3.9 percent in dollars, while imports increased 12.5 percent by the same measure, resulting in a 16.9 percent decline in the imbalance for the year to $64.4 billion (see Tables). The drop would have been far greater if the first quarter of 1989 had not moved in the opposite direction.

Forces that had been at work all year gained strength during the final three months of the year. Dollar-denominated exports dropped 3.6 percent, the first year-to-year cutback since the first quarter of 1985. Imports in the quarter were up 14.5 percent. The result was a whopping 40 percent decline in the excess of exports over imports and the lowest fourth-quarter surplus on a dollar basis since 1984.

Do the fourth-quarter figures suggest that Japan's trade surplus might be a thing of the past within a couple of years? That would be an exaggeration. In part, the decline was a reaction to the abnormally large October-December 1988 surplus that so agitated the revisionists. In addition, the J-curve effect, which results from the opposite movements -- and differences in timing -- between the price and the volume effects of exchange rate changes, had an influence during the period. The yen was 11.5 percent weaker in the fourth quarter of 1989 than during the same period of 1988, implying that goods priced in yen appeared cheaper when expressed in dollars. As a result, dollar-denominated exports and imports were both smaller than otherwise in 1989, which tended to reduce the size of the imbalance.

Imports rose in part because oil prices, which were somewhat higher on average last year than in 1988, jumped in the fourth quarter of 1989. Of the 14.5 percent expansion in dollar-denominated imports in the fourth quarter, approximately one-third was accounted for by more expensive oil compared to the

Japan's Total Trade in Dollar Terms

(in millions of dollars)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1985	$175,638	3.2%	$129,539	-5.1%	$46,099
1986	209,151	19.1	126,408	-2.4	82,743
1987	229,221	9.6	149,515	18.3	79,706
1988	264,917	15.6	187,354	25.3	77,563
1989 (p)	275,173	3.9	210,739	12.5	64,434
1987: I	51,464	13.1	31,977	-3.1	19,487
II	56,931	7.1	36,380	15.8	20,551
III	57,855	5.6	38,346	27.2	19,509
IV	62,972	13.0	42,812	34.5	20,159
1988: I	60,279	17.1	44,505	39.2	15,774
II	65,179	14.5	47,260	29.9	17,919
III	67,169	16.1	47,258	23.2	19,911
IV	72,291	14.8	48,331	12.9	23,960
1989: I	68,247	13.2	51,147	14.9	17,100
II	67,632	3.8	51,272	8.5	16,360
III	69,605	3.6	53,005	12.2	16,600
IV (p)	69,690	-3.6	55,316	14.5	14,374

Japan's Total Trade in Yen Terms

(in billions of yen)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1985	Y41,956	4.0%	Y31,085	-3.8%	Y10,871
1986	35,290	-15.9	21,551	-30.7	13,739
1987	33,315	-5.6	21,737	0.9	11,578
1988	33,939	1.9	24,006	10.4	9,933
1989 (p)	37,822	11.4	28,963	20.6	8,858
1987: I	7,960	-8.2	4,959	-21.7	3,002
II	8,153	-10.6	5,207	-3.6	2,946
III	8,507	-1.5	5,644	18.6	2,864
IV	8,694	-1.9	5,928	17.2	2,767
1988: I	7,713	-3.1	5,688	14.7	2,025
II	8,163	0.1	5,918	13.6	2,246
III	8,924	4.9	6,280	11.3	2,644
IV	9,139	5.1	6,121	3.3	3,018
1989: I	8,707	12.9	6,516	14.6	2,191
II	9,226	13.0	6,994	18.2	2,232
III	9,912	11.1	7,541	20.1	2,371
IV (p)	9,977	9.2	7,912	29.3	2,065

Japan's Trade with the United States in Dollar Terms

(in millions of dollars)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1985	$65,278	8.9%	$25,793	-4.0%	$39,485
1986	80,456	23.3	29,054	12.6	51,401
1987	83,580	3.9	31,491	8.4	52,090
1988	89,634	7.2	42,037	33.5	47,597
1989 (p)	93,186	4.0	48,184	14.6	45,002
1987: I	18,001	7.8	6,986	11.3	11,015
II	21,181	1.2	7,592	-8.6	13,589
III	21,628	1.6	8,252	9.7	13,376
IV	22,770	5.6	8,660	24.7	14,110
1988: I	19,859	10.3	10,090	44.4	9,769
II	21,610	2.0	10,458	37.8	11,152
III	23,056	6.6	10,667	29.3	12,389
IV	25,109	10.3	10,821	25.0	14,288
1989: I	22,728	14.4	11,566	14.6	11,162
II	23,011	6.5	12,065	15.4	10,946
III	24,118	4.6	12,444	16.7	11,674
IV (p)	23,329	-7.1	12,109	11.9	11,220

Japan's Trade with the United States in Yen Terms

(in billions of yen)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1985	Y15,583	9.6%	Y6,213	-2.4%	Y9,369
1986	13,564	-13.0	4,918	-20.9	8,646
1987	12,148	-10.4	4,582	-6.8	7,566
1988	11,487	-5.4	5,388	17.6	6,099
1989 (p)	12,816	11.6	6,624	22.9	6,192
1987: I	2,786	-12.7	1,083	-9.9	1,703
II	3,034	-15.5	1,086	-23.6	1,948
III	3,180	-5.2	1,215	2.1	1,965
IV	3,148	-8.2	1,198	8.5	1,950
1988: I	2,541	-8.8	1,290	19.1	1,251
II	2,706	-10.8	1,309	20.5	1,397
III	3,063	-3.6	1,418	16.7	1,645
IV	3,177	0.9	1,371	14.4	1,806
1989: I	2,900	14.1	1,474	14.2	1,426
II	3,141	16.1	1,649	25.9	1,493
III	3,436	12.2	1,770	24.8	1,666
IV (p)	3,339	5.1	1,732	26.4	1,607

year-earlier period. However, Japan's trade surplus in both the fourth quarter and the year would have narrowed even in the absence of J-curve effects or oil price increases. Export volume for the September-December period was unchanged compared with a year earlier, while import volume jumped 8.9 percent. For the year exports in real terms grew 4.3 percent and the comparable import number increased 7.8 percent over 1988.

During 1989 changes in Japan's trade with the United States mirrored those with the rest of the world, although the trends were less pronounced. The bilateral surplus inched down to $45 billion, although it rose slightly in yen terms. During the fourth quarter, however, the decline in the surplus in both yen and dollar terms was dramatic, with the dollar measure showing a 21.5 percent contraction.

Some Japanese observers are troubled by the increasing percentage of Japan's surplus accounted for by the United States. The bilateral imbalance represented 61.4 percent of the total in 1988; in 1989 the figure rose to 69.8 percent. This reflects an analogous trend in the U.S. data that worries many U.S. policymakers: a rising percentage of the U.S. trade deficit is accounted for by Japan. In other words, the United States and Japan have made progress on their overall trade deficits and surpluses, respectively, but the bilateral imbalance appears to be relatively stubborn as measured by either country's data. Economists are virtually unanimous in believing that global imbalances are of far greater importance than bilateral ones and tend to dismiss such findings; politicians disagree. With the temperature of the political rhetoric determined by the bilateral imbalance, these data suggest that discussions between Washington and Tokyo will remain heated.

Douglas Ostrom

Japan's Savings Rate Dips In 1988

The Economic Planning Agency had a good news/bad news story in mid-January for those in Japan and abroad unhappy about Japan's high savings rate. The good news: savings in Japan, measured as a percentage of household disposable income, dipped to a 22-year low of 14.8 percent in 1988, down from 15.1 percent in 1987. During the mid-1970s the rate averaged above 20 percent before drifting downward in the 1980s. The bad news: even the lower 1988 figure was enough to keep Japan near the top among the 24 members of the Organization for Economic Cooperation and Development and well ahead of the United States, which registered a 4.2 percent rate in 1988, up from 3.2 percent in 1987.

In the current Structural Impediments Initiative talks both the United States and Japan have put savings rates on the short list of complaints about the other's economy. Tokyo feels that Americans undersave and Washington argues that the Japanese oversave. The latest figures suggest that, at least among households, savings rates converged ever so slightly in 1988.

EPA believes that Japan's household savings rate will continue declining, reaching 13 percent in 1993 and 11 percent by the turn of the century. Extrapolation of the rates for other industrial countries suggests that Japan's rate could dip below that of West Germany by the middle of this decade. In 1988 West Germany's household savings rate, which has been showing a steady increase since the mid-1980s, was 12.6 percent.

Households, of course, are only one source of savings. Business and government also save or dissave. For example, higher corporate profits and depreciation charges reduce the need for businesses to rely on household savings, other factors being equal. More comprehensive Japanese measures that account for savings outside the household sector are not available for 1988, but in 1987 overall savings came to 18.2 percent of gross national product. Of this, 56 percent, or an amount equivalent to 10.2 percent of GNP, came from households. These figures suggest that personal savings are an important, but not overwhelming, source of funds to finance domestic and foreign investment.

Japanese savings, including that by households, matter to Washington. Savings are a factor in financing the U.S. trade deficit; in the process these funds prop up the dollar by creating a demand for dollars and a supply of yen. Moreover, Washington fears that funds that stay in Japan could finance capacity expansion and lead to an export surge.

Various academic studies and common sense both suggest that, in Japan and elsewhere, savers and financial intermediaries prefer to invest their funds domestically, provided they can get competitive returns. Hence, most experts link high savings to high investment levels. During 1988 Japanese firms invested 17.5 percent of GNP in plant and equipment, far ahead of the U.S. rate of 10 percent. Investment spending, in turn, is one of the building blocks of greater productivity and economic growth. American policymakers, then, have an obvious interest in discovering the secrets of Japan's high savings rate in their search for ways to boost this country's economic performance. In Washington much of the talk has centered on the tax system as a way of inducing American households to save. As part of his budget for FY 1991 President Bush recently proposed new tax incentives to make Americans more inclined to save.

However, Professor Hiromitsu Ishi of Hitotsubashi University, in a recent study covering the period 1965 to 1986, failed to find a definite relationship between taxation and personal savings rates in Japan. Mr. Ishi argues that socioeconomic factors and economic growth are probably far more important than the tax system in explaining why Japanese households save so much. His analysis suggests that Tokyo has only limited ability to alter Japanese household savings behavior. Moreover, if Americans respond to the same economic incentives as the Japanese, his research is bad news for those in Washington hoping that a quick fix based on tax changes will lift American savings and investment levels closer to those of Japan.

Douglas Ostrom

Japanese Research Spending Rises

Japanese outlays for research and development continue to grow rapidly, spurred by economic restructuring and fear of losing international economic competitiveness due to the yen's strength against major currencies. While there is agreement that Japanese spending expanded at a healthy pace in fiscal 1988 and again in FY 1989, the outlook for the future is mixed. The current U.S. research spending picture, too, is mixed, leading observers to question the long-term impact of these spending trends on the bilateral and the overall trade balances of both countries.

According to a preliminary report by the Management and Coordination Agency, total Japanese research spending rose 8 percent in FY 1988 to just over Y10.6 trillion ($75.9 billion at Y140=$1.00), equivalent to 2.85 percent of that year's gross national product (see Table 1). Private companies accounted for the lion's share of the increase, recording an 11.2 percent hike to Y7.2 trillion ($51.6 billion). Struggling under the impact of an austere government fiscal policy, research spending by universities (Y2 trillion or $14.4 billion) and research laboratories (Y1.4 trillion or $10 billion) registered anemic gains.

Table 1: Japan's R&D Expenditures, FY 1984-FY 1988

(in billions of yen and percent)

Fiscal Year	Companies	Research Institutions	Universities	Total
1984	Y5,136.6	Y1,033.1	Y1,724.2	Y7,893.9
Change	12.6%	6.4%	4.5%	9.9%
Share	65.1%	13.1%	21.8%	100.0%
1985	5,939.9	1,160.6	1,789.8	8,890.3
Change	15.6%	12.3%	3.8%	12.6%
Share	66.8%	13.1%	20.1%	100.0%
1986	6,120.2	1,240.2	1,832.6	9,192.9
Change	3.0%	6.9%	2.4%	3.4%
Share	66.6%	13.5%	19.9%	100.0%
1987	6,494.3	1,384.5	1,957.9	9,836.6
Change	6.1%	11.6%	6.8%	7.0%
Share	66.0%	14.1%	19.9%	100.0%
1988	7,219.3	1,394.2	2,014.1	10,627.6
Change	11.2%	0.7%	2.9%	8.0%
Share	67.9%	13.1%	19.0%	100.0%

As for how the money was spent, the agency survey revealed that basic research remains a low priority despite government exhortations to the contrary (Table 2). The majority of natural science research funds, for example, continued to flow to developmental research in the year through March 1989, underscoring the strong emphasis Japanese firms place on quick conversion of technological advances into commercial products. Applied research, one step away from actual products, grew almost as much as developmental research but remained far smaller. Basic research grew a paltry 3 percent in FY 1988, highlighting the nation's weakness in this area.

According to two other sources, Japan's R&D spending has continued to expand smartly in FY 1989. An Economic Planning Agency survey released last November predicted that Japan's manufacturing sector would spend in excess of Y3 trillion ($21.4 billion) on R&D in the year ending March 31, 1990. This record achievement caps a decade in which manufacturers' R&D outlays rose at an average annual rate of more than 10 percent. Responding to American fears that this strong spending growth would encourage an export surge, an EPA spokesman emphasized that the money was not being used for capacity expansion. If research spending leads to products that embody more technology and therefore higher value-added, however, constant or declining export volumes could be offset by increases in unit export values.

Table 2: Japan's Natural Science Research Expenditures by Purpose, FY 1984-FY 1988

(in billions of yen and percentage share)

Fiscal Year	Basic Research	Applied Research	Developmental Research
1984	Y959.9	Y1,780.8	Y4,340.2
	13.6%	25.1%	61.3%
1985	1,030.6	2,001.8	4,985.9
	12.9%	25.0%	62.2%
1986	1,102.8	2,030.8	5,185.0
	13.3%	24.4%	62.3%
1987	1,250.2	2,166.8	5,497.3
	14.0%	24.3%	61.7%
1988	1,288.0	2,346.6	6,041.0
	13.3%	24.3%	62.4%

Source for Tables 1-2: Management and Coordination Agency, Report on the Survey of Research and Development.

The Japan Development Bank painted an even rosier picture of corporate R&D spending in FY 1989. An October JDB survey showed research expenditures by all industries rising 20.4 percent. Leading with an 80.2 percent increase were electric utilities; nonmanufacturing businesses were expected to spend 53.8 percent more in the current fiscal year, and manufacturing industries, 16.6 percent more. Within the manufacturing sector, electric machinery makers topped the list with a 54.9 percent increase, followed by food processors (42.7 percent), shipyards (31.9 percent) and chemical companies (28.5 percent). The non-electric machinery and automotive industries showed increases of just 7.6 and 6.4 percent, respectively. Washington recently expressed concern that the capital spending plans of Japanese automakers may foreshadow a worsening of bilateral trade in cars.

The JDB survey diverged from mainstream opinion, however, by predicting that industrial R&D outlays will grow a meager 1.5 percent overall in FY 1990. EPA remains confident that research spending by the manufacturing sector will accelerate as Japanese companies realize the need to increase basic research efforts. As the Management and Coordination Agency's figures show, however, this realization may be some time in coming.

In the United States the debate concerns current corporate R&D spending. According to a new report by the National Science Foundation, research expenditures by American corporations fell in 1989 after adjustment for inflation, capping a worrisome trend that began in 1985. Between 1976 and 1985, according to NSF, corporate R&D grew at an average rate of 12.7 percent a year. Since then, however, the annual growth rate has withered to just 1.6 percent. From the viewpoint of some private surveys, however, the picture is not at all grim. According to Business Week's annual survey of research spending, American industries spent $59.4 billion in 1988, a gain of 11 percent. On top of fears that military R&D funds will be slashed, the conflicting figures are sure to obscure further already confused discussions over whether the United States should change its traditional approach to industrial development.

Jon Choy